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Business and Economic Conditions

New York, April 1960

General Business Conditions

THE most conspicuous business news during March did not center on production and trade, where activity on the whole was well sustained, but rather on the financial markets. The renewed decline in the stock market, to lows on March 9 which were 13 per cent under the record high achieved on the first trading day of the new year, raised questions in people's minds as to the outlook. The simplest, and also most accurate, explanation of the setback in stocks has been provided by Federal Reserve Board Chairman William McC. Martin, one-time president of the New York Stock Exchange, who said the decline represented "liquidation of inflation psychology."

Inflation psychology received a telling blow from the President's proposal, in the State of the Union message on January 7, for a $4.2 billion surplus in the fiscal year beginning July 1. But, even before, it had been undermined by the widening public appeal of 4¾ to 5 per cent rates on U. S. Treasury securities — yields which made common stocks look very high indeed when valued on a basis of current investment return.

Since the President's budget surplus proposal, bond prices, moving opposite to stocks, advanced smartly to the highest levels in a year. This recovery in bonds has been helped by the appearance of perhaps unwarranted pessimism over the business outlook. In the money market, yields on 91-day Treasury bills, plummeting below 3 per cent, seemed to be saying that the Federal Reserve might soon cut discount rates to encourage business expansion.

A Business Plateau

Pessimists could point to a nominal retreat of the Federal Reserve Board's index of industrial production (1957 = 100) from 111 in January to 110 in February. They could also point to a gradual slippage in steel mill operating rates from 95 to 89 per cent of capacity. But, broadly, the business pattern is more fairly described as a high level plateau than anything else.

Most major types of production tended to level off in February. The seasonally adjusted Federal Reserve index of materials output (including steel) was unchanged from January, and so was production of business and defense equipment. Manufacture of apparel, food, and other consumer staples remained at the high January level; such decline as occurred centered in passenger cars and household durable goods.

Despite successive cutbacks in passenger car production, as stormy weather cut into sales, the automobile companies built nearly two million cars during the first quarter. Sales, although somewhat disappointing at first, ran 10 per cent ahead of 1959, suggesting 1960 sales of at least six million domestic cars. Dealers' stocks mounted to more than one million, providing a wide selection of makes and models on the eve of the spring selling season.

Tentative official guesses put the total value of all goods and services produced in the first

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quarter of this year at an annual rate of approximately $500 billion, a sizable increase over the $483.5 billion rate in the preceding quarter. Recovery from the steel strike and an abnormally high rate of inventory building accounted for much of the steep rise, but there were also significant increases in consumer spending and business fixed investment.

The possible strength of further increases in consumer demand has been beclouded by the adverse weather conditions in February and March and, to a lesser extent, by the three-weeks later date of Easter this year. Retailers are hoping that spring weather will help release more of the spending power being generated by the current high level of business. A trend to more optimistic attitudes among consumers and an increase in the number of families planning to buy cars and other durable goods were reported in a recent University of Michigan survey.

Inventory and Capital Investment Policies

Businessmen are exercising commendable restraint in rebuilding inventories. Even in steel, the scramble to rebuild stocks was conspicuously less than in previous post-strike periods. Greatly expanded capacity in steel making, and in other industries as well, gave assurance to customers that goods would be available when needed, while the desire to build stocks as a hedge against price increases all but disappeared. Electronic data-processing, and greater reliance on fast deliveries, have helped keep the level of stocks low in relation to sales. Offsetting this has been the trend toward a multiplicity of styles and models, as in the automobile industry.

Factory stocks rose $600 million during February, a somewhat slower rate of accumulation than in December and January. Shipments of manufactured goods in February advanced to the highest level on record, and new orders increased $700 million over the January rate. New orders for steel fell off, as expected, but were more than offset by a strong pickup in machinery and transportation equipment.

Although businessmen have been conservative in inventory policy, they are gradually enlarging plant and equipment expenditures. The most recent survey by the Securities and Exchange Commission and the Department of Commerce shows business plans for $37.0 billion new capital investment this year, equaling the 1957 record and up 14 per cent from the $32.5 billion spent in 1959. Outlays in the first quarter are estimated at an annual rate of $35.3 billion, about 3 per cent higher than had been anticipated three months ago. The survey shows the biggest gains expected in steel and automobile manufacturing, and also in electrical machinery (including electronics) and chemicals, where new products resulting from research and development work of past years are stimulating added investment.

Prospects for an increase in total construction outlays, topping 1959's record, have been improved by the passing of the acutely tight money market which, three months ago, threatened to enforce a sharp curtailment of home building for want of mortgage money.

The Unemployment "Problem"

Among reassuring indicators of the strength of the economy on a broad front during February were the expansion in employment and the reduction of unemployment. Altogether, 64,520,000 persons were employed, an increase of half a million over January and 1.8 million more than in February 1959. More people had jobs than in any previous February on record. Unemployment, more apt to increase in February, was officially estimated at 3.9 million, 218,000 below January. The proportion of the civilian labor force figured as out of work dropped to 4.8 per cent, seasonally adjusted, from 5.2 per cent in January and 5.9 per cent a year earlier.

The cut in joblessness came in the background of publicly expressed concerns that unemployment might remain high in the midst of an otherwise prosperous economy. The Congressional Joint Economic Committee, commenting a month ago on the President's Economic Report, suggested that the number of new jobs in 1960 might not be much greater than the increase in the labor force, thus keeping unemployment relatively high. The AFL-CIO publication, *Labor's Economic Review*, expresses the same point of view and speaks of "a real danger that unemployment in 1960 may remain close to the high level of joblessness in January, unless sales, production and jobs rise rapidly throughout the year." However, employment has expanded more rapidly than expected. At the same time, the Department of Labor reports that the labor force has been growing more slowly than anticipated. A drop in the unemployment rate during the months ahead matching that in the first two months of 1960 would bring the rate to approximately 4 per cent. This level would be in line with the recent findings of the Joint Economic Committee's staff that over the past fifty years:

> In periods of high prosperity, with modest fluctuations in output and employment, unemployment has averaged about 4 per cent of the labor force.

During the peacetime years since World War II, unemployment has averaged about 4.8 per cent of the labor force. This period, of course,

embraced three business recessions, in 1949, 1954, and 1958. Over the 15 years there have been great changes in the economy and in the kinds of labor in demand. Social security protections have been enlarged, which doubtless relieve some people of need or desire to have jobs to get along. Difficulties of the Government in finding qualified census takers remind us that there are areas of labor shortage as well as of labor surplus.

Measuring Unemployment

There is no magic number representing the "normal" or maximum tolerable level of unemployment. The fact that a certain level of unemployment has been characteristic of prosperous periods in the past does not imply that it should become a fixed objective of national policy to keep joblessness at or below that level. There will be unemployment so long as we do not force people to work and do not deny them freedom to look for something better.

In any case the measurement of unemployment is still far from an exact science. The figures as officially reported by the Bureau of Labor Statistics have come under attack both as understating and as overstating the number unemployed. Labor union spokesmen have called the figures too low because they do not reflect underemployment in the form of part-time work and because they do not take account of all the persons who would have looked for work but did not think jobs were available. On the other hand, it has been noted that the unemployment figures include some people who already have jobs, others whose efforts to find work may be at a minimum, as well as many students, housewives, and retired persons who are not regular full-time members of the labor force.

Fundamentally, unemployment statistics in this country are estimates of the number of people without jobs and looking for work. A few other categories have been added: persons with jobs but temporarily laid off or waiting to report, and persons not looking for work because of illness. The data are gathered by interviewing a selected sample of about 35,000 households each month.

No matter how carefully the official definitions are drawn, however, unemployment means different things to different people at different times. Some of the problems in measuring this elusive concept have been outlined by Commissioner of Labor Statistics Ewan Clague:

> The major problem with employment and unemployment statistics is that they deal not only with people's activities, but also with their attitudes, motives, and judgments, and therefore are subject to uncertainty over and beyond normal statistical error.
>
> . . . A man says that he is out of work at the moment, although he has previously held jobs of various kinds. But is he unemployed? Suppose he has in mind taking it easy for a few months and doesn't intend to look for a job until spring. Or suppose, again, that he has decided not to look for work because he doesn't think there will be any jobs available until the factory reopens. Or, once more, suppose he has been laid off by the company during stock-taking, but has been notified that in a couple of weeks he will be called back to work. The fact that he has no job may be relatively easy to determine, but whether he is unemployed or has temporarily left the labor force is not so easy to find out.

Whatever definition of unemployment is used in determining economic policy, it is soon apparent that the heart of the problem is not "how many" but "who" and "why". Unemployment totals make no distinction, but it makes a considerable difference whether the person unemployed is the sole support for a young family or a teen-ager looking for baby-sitting jobs. Some persons counted as employed – such as men doing odd jobs while seeking regular full-time work – may be looking for work harder than many ostensibly unemployed persons, including housewives seeking pin-money jobs, older persons trying to supplement their pensions, not to mention the indolent maintaining a pretense of job hunting while collecting unemployment insurance.

Some of the basic characteristics of unemployment are brought out in the detailed statistics. Unemployment is more prevalent among workers with the lowest skills and least training; laborers, semiskilled operatives, and persons with no previous work experience account for well over half of all jobless workers. Nonwhites comprise over one fifth of all the unemployed – about twice their proportion of the labor force.

Achievement of Growth

In the background of the seemingly intractable unemployment problem that plagued the nation during the dismal decade of the Thirties, public policy since World War II has placed its primary emphasis upon avoidance of periods of serious unemployment. This emphasis is apparent in the Employment Act of 1946 which, omitting mention of economic growth or price stability save perhaps by implication, asserted national objectives of maximizing employment, production, and purchasing power. The same primary emphasis on employment is evident in the title of the Joint Economic Committee's special study, released two months ago, *Employment, Growth, and Price Levels*. This title, at least, gives a better balance of economic policy objectives.

There are often assumptions that a low rate of unemployment and a high rate of growth go together, though this does not necessarily follow. The national production may keep up with the

growth of the labor force if there are enough tools to go around and everyone is kept working full time. But the labor force is required to adjust itself if standards of living are to rise, if new labor-saving devices are to permit shortened working hours, and if government, business, and the people at large are to remain free to change their minds about how they want to spend their money. In an economy of dynamic change and growth, some persons are being laid off while others are finding new employment opportunities. In other words, some unemployment is a price of progress.

On March 30 a Special Senate Committee on Unemployment Problems, set up in the spring of 1959, submitted its report. According to an Associated Press dispatch from Washington, the report noted that there had been no mass unemployment in recent years but expressed the opinion that unemployment was a grave national problem requiring comprehensive remedial action before an exploding population made it worse. While offering a variety of relief measures to make work, or to ease the discomforts of unemployment, the Committee emphasized revised government policies, fiscal and others, to stimulate economic growth.

Encouragement of private enterprise, as by tax reforms, is the key necessity to reinvigorate the forward thrust of the American economy.

Corporate Earnings in 1959

Annual reports for the year 1959 published to date by 3,331 corporations show combined net income after taxes of approximately $21.2 billion, an increase of 18 per cent over the recession year 1958, compared with 20 per cent shown in our preliminary summary of some 2,400 companies given last month. The rise may have been sufficient to put profits for all U.S. corporations up to the old peak recorded back in 1956.

Gains in earnings last year reflected recovery, or strengthened growth, in sales or revenues as well as continuing labors over problems of cost control. For many firms the introduction of new or improved products, results of research and development, played a significant part. The most spectacular gains were recorded by small new companies in the scientific field.

Leaving out financial institutions, aggregate sales and revenues of companies included in our tabulation ran up to $314 billion. On this base, the combined net income after taxes represented a net profit margin of 6.0 per cent. This compares with 5.5 per cent in 1958, but is below the twelve-year average, 1947-58, of 6.4 per cent. Following are the changes by main divisions of business, while the table on the next page gives the figures by 65 major industry groups, together with rates of return on book net assets.

Net Income of Leading Corporations for the Years 1958 and 1959

(Dollar Figures in Millions)

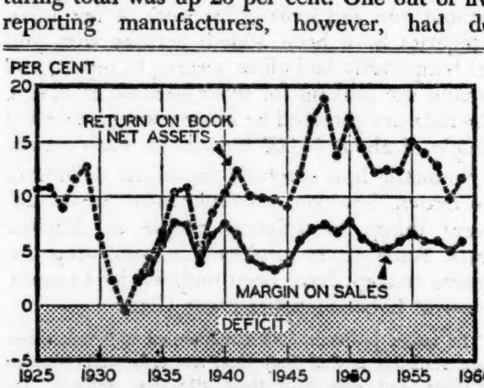
No. of Cos.	Industry Divisions	Net Income After Taxes 1958	Net Income After Taxes 1959	Per Cent Change	% Margin on Sales 1958	% Margin on Sales 1959
1,944	Manufacturing	$10,683	$13,327	+25	5.2	5.8
58	Mining	155	181	+17	6.9	6.5
246	Trade (ret. & wh.)	821	945	+15	2.3	2.5
231	Transportation	771	792	+ 3	5.6	5.2
294	Public utilities	3,017	3,387	+12	13.5	13.6
132	Amuse., services	164	211	+28	3.9	4.7
426	Banks and finance	2,436	2,406	— 1	—	—
3,331	Total	$18,047	$21,250	+18	5.5	6.0

Book net assets of all the reporting companies aggregated $217 billion at the beginning of 1959, upon which the year's net income represented an average return of 9.8 per cent. This was above the 8.9 per cent for 1958, but below the twelve-year average, 1947-58, of 11.3 per cent. Book net assets (also called net worth, or capital and surplus, or shareholders' equity) are based upon the excess of total balance sheet assets over liabilities. It should be borne in mind in this kind of computation that the amounts at which assets are carried on the books are usually far below present-day values.

Despite the preponderance of plus signs in the net income changes by major industry groups, an important minority of companies experienced declines because of lagging sales or mounting expenses. The fourth quarter was the poorest in comparison with 1958. Affected by the spreading impact of the 116-day steel strike, net income of the reporting companies as a whole fell below fourth quarter 1958 results.

Trends in Manufacturing

For the 1,944 reporting manufacturing companies the combined net income was up 25 per cent. Excluding the steel group, the manufacturing total was up 26 per cent. One out of five reporting manufacturers, however, had de-



Annual Average Net Profit Margins on Sales and Rates of Return on Book Net Assets of Leading Manufacturing Corporations

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1958 AND 1959

(Dollar Figures in Thousands)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1958	Reported Net Income After Taxes 1959	Per Cent Change	Book Net Assets Jan. 1-a 1958	Book Net Assets Jan. 1-a 1959	% Return on Net Assets-a 1958	% Return on Net Assets-a 1959	% Margin on Sales-b 1958	% Margin on Sales-b 1959
18	Baking	$ 63,495	$ 66,197	+ 4	$ 544,703	$ 579,893	11.7	11.4	3.2	3.4
14	Dairy products	108,138	116,018	+ 7	904,948	969,202	11.9	12.0	2.6	2.6
28	Meat packing	40,058	70,875	+77	896,358	912,810	4.5	7.8	0.5	1.0
18	Sugar	33,119	30,288	— 9	545,165	521,506	6.1	5.8	3.5	3.0
84	Other food products	366,497	393,036	+ 7	3,205,539	3,372,970	11.4	11.7	4.2	4.1
13	Soft drinks	51,570	60,711	+18	357,331	385,628	14.4	15.7	7.9	8.3
21	Brewing	24,832	31,891	+28	362,616	369,575	6.8	8.6	3.0	3.4
13	Distilling	95,404	106,921	+12	1,309,614	1,353,494	7.3	7.9	3.6	3.8
17	Tobacco products	229,150	249,050	+ 9	1,562,270	1,660,349	14.7	15.0	5.7	5.8
67	Textile products	111,190	216,538	+95	2,692,407	2,694,082	4.1	8.0	2.7	4.3
48	Clothing and apparel	28,482	45,458	+60	458,974	469,864	6.2	9.7	2.7	3.6
20	Shoes, leather, etc.	38,939	48,148	+24	424,691	434,846	9.2	11.1	3.0	3.3
27	Tires, rubber products	209,736	264,492	+26	1,972,401	2,068,309	10.6	12.8	4.1	4.5
27	Lumber	108,038	143,150	+32	1,173,221	1,232,004	9.2	11.6	6.7	7.5
19	Furniture, wood products	25,814	34,508	+34	299,905	309,516	8.6	11.1	3.5	4.5
72	Paper and allied products	355,690	422,969	+19	3,841,593	4,034,468	9.3	10.5	6.2	6.5
45	Printing and publishing	71,364	82,397	+15	631,953	679,433	11.3	12.1	4.3	4.3
71	Chemical products	819,759	1,105,216	+35	7,373,282	7,689,796	11.1	14.4	7.2	8.9
27	Drugs and medicines	294,112	322,863	+10	1,342,634	1,472,795	21.9	21.9	11.4	11.6
20	Soap, cosmetics, etc.	131,637	155,693	+18	830,968	929,218	15.8	16.8	5.4	5.9
24	Paint and varnish	94,031	117,137	+25	732,628	791,732	12.8	14.8	6.4	7.0
131	Petroleum prod. and refining	2,575,505	2,814,334	+ 9	26,031,627	28,135,967	9.9	10.0	8.4	8.4
27	Cement	131,310	149,519	+14	802,848	870,482	16.4	17.2	16.1	16.3
16	Glass products	136,330	200,499	+47	1,141,719	1,200,151	11.9	16.7	7.1	8.9
53	Other stone, clay products	203,900	268,719	+32	1,709,836	1,849,572	11.9	14.5	7.9	8.9
51	Iron and steel	789,174	843,793	+ 7	9,680,804	10,010,630	8.2	8.4	6.3	6.0
12	Agricultural implements	142,485	209,313	+47	1,942,449	1,947,144	7.3	10.8	4.6	5.8
80	Building, heat., plumb. equip.	125,001	147,530	+18	1,547,067	1,610,414	8.1	9.2	3.4	4.0
132	Electrical equip., radio & tv	613,630	766,007	+25	4,929,308	5,314,962	12.4	14.4	4.2	4.8
48	Hardware and tools	39,003	54,793	+40	628,223	638,811	6.2	8.6	4.0	4.7
38	Household appliances	75,882	110,069	+45	979,580	1,010,238	7.7	10.9	3.9	5.8
158	Machinery	233,558	300,752	+29	2,947,944	3,033,806	7.9	9.9	4.3	5.0
30	Office equipment	175,058	198,024	+13	1,273,531	1,409,988	13.7	14.0	6.6	6.5
45	Nonferrous metals	309,802	382,945	+24	4,524,261	4,659,187	6.8	8.2	6.4	6.7
90	Instruments, photo. goods, etc.	199,521	298,266	+47	1,637,519	1,784,211	12.2	16.4	5.7	6.7
122	Other metal products	240,485	312,938	+30	2,690,221	2,762,242	8.9	11.3	4.0	4.4
16	Autos and trucks	757,710	1,471,999	+94	8,315,477	8,463,891	9.1	17.4	4.2	6.7
53	Automobile parts	119,584	206,379	+73	1,612,210	1,656,662	7.4	12.5	3.6	4.2
19	Railway equipment	62,984	82,778	+31	1,030,835	1,053,840	6.1	7.9	3.5	4.4
43	Aircraft and parts	294,756	202,607	—31	2,093,656	2,289,220	14.1	8.9	2.6	1.8
107	Misc. manufacturing	156,186	227,421	+46	1,700,208	1,812,873	9.2	12.5	3.8	4.7
1,944	Total manufacturing	10,682,920	13,327,246	+25	108,683,014	114,445,736	9.8	11.6	5.2	5.8
21	Coal mining - e	61,306	71,168	+16	975,851	978,672	6.3	7.3	5.4	5.1
27	Metal mining - e	50,975	63,629	+25	806,415	857,981	6.3	7.4	6.2	6.1
10	Other mining, quarrying - e	42,479	46,166	+ 9	341,833	431,836	12.4	10.7	19.5	18.0
58	Total mining, quarrying	154,760	180,958	+17	2,124,099	2,268,489	7.3	8.0	6.9	6.5
42	Chain stores — food	214,430	226,477	+ 6	1,467,088	1,624,356	14.6	13.9	1.4	1.4
56	Chain stores — variety, etc.	133,582	154,388	+16	1,511,869	1,566,115	8.8	9.9	2.8	3.1
57	Department and specialty	172,322	200,096	+16	1,861,711	1,924,210	9.3	10.4	2.5	2.7
6	Mail order	202,410	245,406	+21	1,929,074	2,010,919	10.5	12.2	3.9	4.3
85	Wholesale and misc.	98,168	118,772	+21	1,014,988	1,075,808	9.7	11.0	2.0	2.2
246	Total trade	820,907	945,084	+15	7,784,730	8,201,408	10.5	11.5	2.3	2.5
113	Class 1 railroads - d	601,820	578,314	— 4	17,102,896	17,142,266	3.5	3.4	6.3	5.9
28	Traction and bus	19,994	32,176	+61	425,746	430,179	4.7	7.5	1.0	2.7
14	Shipping	54,224	40,851	—25	688,008	737,504	7.9	5.5	9.2	4.7
16	Air transport	48,369	77,375	+60	756,657	807,937	6.4	9.6	2.7	3.4
60	Misc. transportation	46,277	63,518	+37	473,224	487,958	9.8	13.0	4.0	4.1
231	Total transportation	770,684	792,234	+ 3	19,441,531	19,605,844	4.0	4.0	5.6	5.2
256	Electric power, gas, etc. - d	1,906,440	2,084,449	+ 9	19,472,518	20,531,621	9.8	10.2	13.4	13.2
38	Telephone & telegraph - d	1,110,426	1,302,598	+17	11,586,987	12,952,635	9.6	10.1	13.8	14.1
294	Total public utilities	3,016,866	3,387,047	+12	31,059,505	33,484,256	9.7	10.1	13.5	13.6
28	Amusements	14,013	46,571	+—†	495,038	489,446	2.8	9.5	2.2	4.0
84	Restaurant and hotel	24,240	24,921	+ 3	261,398	288,544	9.3	8.6	2.6	3.2
47	Other business services	93,206	106,286	+14	930,023	978,819	10.0	10.9	6.0	6.3
23	Construction	32,878	32,924	+—†	260,942	278,173	12.6	11.8	3.7	4.4
182	Total amusements, services, etc.	164,337	210,702	+28	1,947,401	2,034,982	8.4	10.4	3.9	4.7
*	Commercial banks	1,457,000	1,252,000	—14	15,086,000	15,842,000	9.7	7.9	—	—
62	Fire and casualty insurance	179,872	274,147	+52	3,183,303	4,022,678	5.6	6.8	—	—
225	Investment trusts - e	531,837	598,565	+13	11,219,214	15,157,965	4.7	3.9	—	—
77	Sales finance	249,798	256,830	+ 3	1,713,257	1,871,340	14.6	13.7	—	—
62	Real estate	17,739	24,947	+41	212,368	222,328	8.3	11.2	—	—
426	Total finance	2,436,246	2,406,489	— 1	31,419,642	37,116,311	7.8	6.5	—	—
3,331	Grand total	$18,046,720	$21,249,760	+18	$202,459,922	$217,157,021	8.9	9.8	5.5	6.0

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. *—Federal Reserve Board tabulation of all member banks; number of banks (6,233) not included in our totals; assets are annual averages. †—Increases or decreases of under 1% or over 100% not shown.

creased earnings for one reason or another. Deficits totaling $129 million were reported in 1959 by 145 companies against deficits totaling $165 million in 1958 by 216 companies.

The long-term trend of earnings in manufacturing is shown in the chart on page 40 based on our annual tabulations of previous years. It will be noted that the earnings rates in 1959 turned upward from the recession levels of 1958, but still remained below the levels realized in most earlier years since World War II.

Net income after taxes as a percentage of total sales recovered, from 5.2 to 5.8 per cent, but it was below the twelve-year 1947-58 average of 6.3 per cent. This includes income from investments and other sources as well as sales.

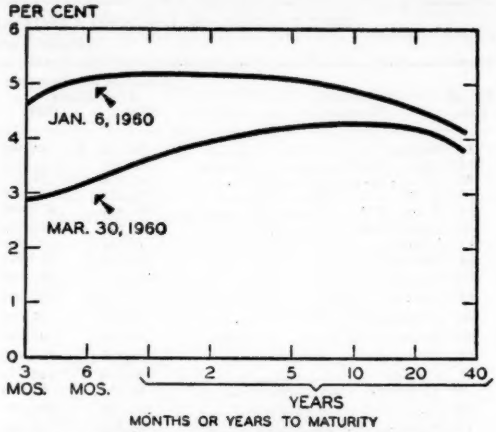
Likewise, net income after taxes as a percentage of book net assets rose from 9.8 to 11.6 per cent. It also was below the twelve-year average of 14.2 per cent. Because of the understatement generally of book net assets, the rates of return, if computed on present-day replacement costs of assets, would be considerably lower. Moreover, depreciation charges based on historical costs are usually much less than they would be if computed on the higher costs now prevailing, which means that book earnings are correspondingly overstated.

Finally, the earnings as reported in financial statements are in most instances far above what is passed on to shareholders in the form of dividends. American corporations as a whole over the past ten years have retained almost half of their earnings for financing growth and modernization. Profit-plowback has been the principal source of additional equity capital for industry.

Drop in Money Rates

To the bewilderment of professionals in Wall Street, open market money rates tumbled further during March. Three-month Treasury bills, which in December were selling to yield 4⅝ per cent, traded as low as 2⅝ per cent. Sales finance company notes, commercial paper, and bankers acceptances were marked down in successive steps, vainly trying to keep pace with the drop in bill yields. Toward the month end, as higher rates in Europe induced some outflow of funds, the money market showed a steadier tone but left on the record books a precipitous decline for which few parallels can be found in American financial history.

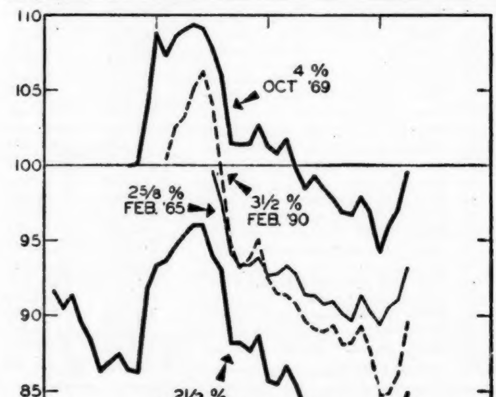
At the same time, bond prices were marked up further. The few high-grade corporate bond issues floated during March were placed at yields to the investor averaging 4.66 per cent



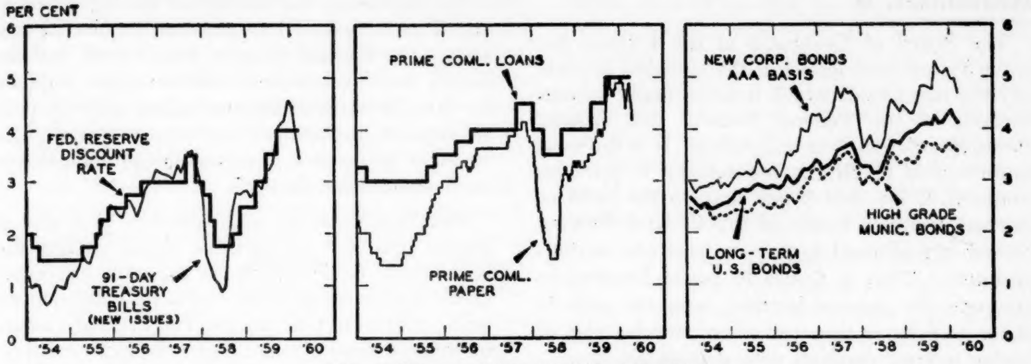
Yields on U.S. Treasury Obligations by Maturity
Yields on March 30 Compared with Those on January 6
(logarithmic time scale)

(Aaa-basis) against a 5.16 per cent average during the final four months of 1959. The most dramatic price markups were in U.S. notes and bonds which, at their peaks on March 23, reached the best levels in a year. Yields on U.S. securities eroded to a point where, on that date, only eight issues, mostly in the 10-20 year range, offered more than 4 per cent. At the low prices of the market on January 6, nineteen issues of U.S. securities, including six longer-dated bill issues, had offered yields in excess of 5 per cent.

The market for U.S. obligations, oversold in early January, was getting the benefit in March of seasonal retirement of Treasury bills plus a positive scarcity of bond offerings. Of more critical influence were misconceptions that the bond rate limit controversy would leave bonds



Prices of Selected Treasury Bonds
Closing Monthly Bids: Latest Plotting, March 30



Money Rates and Bond Yields, Monthly

in scarce supply* and that the Federal Reserve authorities were all ready to embark upon an outright cheap money policy. While uncommitted to policy reversal, the Federal Reserve has indeed been taking a progressively more relaxed attitude toward credit expansion during the past few months. Some feeling is apparent that credit restriction went too far, and pinched banks too hard, in the second half of 1959.

Negative free reserves of the member banks, around $400 million in January, have been averaging closer to $200 million in recent weeks. Yet, curiously, the banks are still short of funds to lend or invest; recent buying of Treasury bills has not come from banks but from the more important classes of holders – corporations and foreign accounts. The relative shortage of bank loan resources is explained by a declining drift of deposits, set in motion by the earlier rise in open market rates which drained funds out of banks. In New York City alone, deposits were deflated by no less than $1.8 billion or 7 per cent in the year ended March 23. For this result the regulatory limits on rates of interest paid, suffocating banks' ability to compete with the open market, were chiefly responsible.

Cheap Money versus Tax Reform

The circumstances which have dictated an easier line of credit policy are numerous. First and foremost is the failure of a bigger boom to materialize, with widespread price increases and excessive credit demands. The steel wage settlement, accomplished without steel price advances, was a decisive factor, quieting fears of uncontrolled wage-price spiraling. It led production managers to tighten control of inventory, and hence reduced needs for borrowed money.

Inflation psychology got punctured, as anyone can see from the retreat in common stock prices. And it is not without significance that the recovery in bonds, as well as reaction in stocks, dates back to the announcement of the President's plan for a $4.2 billion surplus in the new fiscal year beginning July 1.

It is gratifying to see restraint on federal spending doing an effective job of producing surplus revenues, relieving inflationary pressures, bringing bonds back into good repute, and relieving strain on the money and capital markets. Too little use has been made of budgetary control – the *sine qua non* of economic stability – in the years past.

There is some talk – given credence by the drop in open market money rates – of a cut in Federal Reserve discount rates. Whatever the merits might be of a technical adjustment in those rates, the question arises as to what means of encouragement the U.S. economy should get when and if activity falters. Should it be a cheap money policy, inviting people to borrow to enlarge the spending streams? Should it be another $5 or $10 billion elevation of federal spending to new heights? We saw the consequences of these politically popular policies in the inflation scare, gold outflow, and bond market collapse of 1958-59.

It would seem more sensible to direct attention to long-overdue income tax rate reforms, such as those embraced in the Herlong-Baker bill, with the objectives of invigorating the industry of the people and the international competitive power of the nation. We cannot keep up with Russian progress fettered by the heavy progressive income tax that Karl Marx suggested as a means of making "despotic inroads on the rights of property, and on conditions of bourgeoisie production."

*After the close of business March 31, the Treasury revealed plans for its April financing, designed to raise $2½ billion. While $2 billion of the funds will be sought by selling 4 per cent 2-year 1-month notes, an offering of 4¼ per cent 25-year bonds, callable at par after 15 years, will be made in the hope of raising a further amount of at least $500 million. In this way, the Treasury will take advantage of the strength in the bond market to raise some money and will put to a practical test the much-debated question as to whether any worthwhile amount of bonds can be sold within the 4¼ per cent bond rate limit.

Regulation Q

The Board of Governors of the Federal Reserve System uses letters of the alphabet to identify the regulations which it issues under various sections of the Federal Reserve Act. Among these, Regulation Q is well named. It is the most questionable of all the regulations. It provides limits of 1, 2½, and 3 per cent on the rates of interest member banks of the Federal Reserve System are allowed to pay on time and savings accounts.* Thus it denies to banks freedom to compete for interest-bearing accounts and to share, as fully as they can afford, the benefits of higher interest earnings with depositors.

The principle is asserted and accepted that interest rates should be permitted to fluctuate freely with changing conditions in the money market. The Federal Reserve Board has strongly supported removal of the 4¼ per cent limit on rates payable on U.S. bonds so that the Treasury can put rates on bonds – as on other classes of securities – that will make investors voluntarily want to buy. But, while the Treasury and other borrowers must meet the market in interest rates paid, the banks are made an exception to the rule.

Some people draw the conclusion – and here is another odd aspect – that the authorities want to give the banks the best of both worlds, high rates on loans and investments, low rates on deposits. But actually Regulation Q hurts banks, and most of all those that want to be competitive and expand with the economy. One outstanding recent development in our financial structure has been the growth of so-called nonbank financial intermediaries – free from these limits on rates paid.

Regulation Q gives an unfair competitive advantage to other financial institutions – savings and loan associations, mutual savings banks, and credit unions. Security dealers enter the banking business, soliciting or accepting what are in effect collateralized interest-bearing deposits by the method of selling securities from their investment inventory with an agreement to buy back at a future date. Enterprising Canadian and European bankers take interest-bearing U.S. dollar deposits while expressing amazement that our rules, dedicated to free markets, should bind American banks from competing for the deposits which are their livelihood.

*Payment of interest on demand deposits is forbidden to commercial banks which are members of the Federal Reserve System or insured by the Federal Deposit Insurance Corporation.

Shortly before the passage of the legislation in the Thirties which brought the Regulation into being, the Federal Reserve Board itself had declared that "it is undesirable to further regulate by law the rates of interest which may be paid on deposits, especially since to do so would place member banks at a disadvantage in competition with nonmember banks."

The final curiosity of Regulation Q is that it singles out for competitive disadvantage the commercial banks which are the most important credit source for business and – for smaller business – often the only source. Yet, everyone wants us to have more economic growth, more employment opportunities, and more small businesses coming to life and expanding.

Speaking in New York on March 7, New York's Superintendent of Banks, G. Russell Clark, posed some searching questions for "everyone interested in the future and vigor of our financial system." He made the simple point that "*if* the logic behind Regulation Q is valid, then it would seem to me to be equally valid for other types of financial institutions." The solution consistent with a free competitive society would be to remove the Regulation and trust to the responsibility of bankers, checked by the regular bank examinations, to avoid unsound practices.

Strengthening Our Balance of Payments

Even though the gold loss has been reduced to a trickle, the balance-of-payments deficit of the United States continues to be a topic of discussion and concern. Secretary of the Treasury Anderson has written an article on the subject in the April issue of *Foreign Affairs.* Two weeks ago, the President outlined an export development program to help American exporters to overcome handicaps they encounter in foreign markets because of lack of aids comparable to those enjoyed by competitors in other industrial nations.

Meanwhile, U.S. exports are benefiting from booming business conditions in Europe and Japan, from lowering of barriers against dollar goods, and from increased foreign sales efforts by American manufacturers disappointed with domestic sales volume. More fundamental measures, undertaken earlier, had quieted recurrent rumors that the dollar might be headed for devaluation: the President's budget surplus proposal, the Federal Reserve's restrictive credit policy, the Treasury's resolution to improve federal debt structure, and the steel industry's resistance to wage-price spiraling.

To finance ministers and central bankers abroad, there is reassurance in the very fact that American opinion so widely recognizes that balance-of-payments deficits of $3 or $4 billion a year cannot be indefinitely sustained – even by a country that holds near half of the world's monetary gold stock.

In the view of seasoned experts in international finance at home and abroad, a substantial export surplus is essential if the United States is to continue to make large defense outlays abroad and to supply grants and loans to foreign nations. For the money we send overseas, there must be a counterpart in goods shipped or services provided. Otherwise, the result is an increase in our short-term indebtedness to foreigners, which represents a claim upon the U.S. gold stock. In 1959, for the second successive year, the U.S. balance-of-payments deficit was of the order of $3.5 billion. As 1960 is shaping up, the deficit seems likely to be smaller than last year; but an easing in our payments position does not necessarily indicate that our problems have ended.

Export Development Program

The President's export development program provides, among other things, for intensified dissemination of foreign trade information, strengthening of commercial activities of our Foreign Service, and increased U.S. participation in trade fairs abroad.

Of special interest is a plan to expand the export credit insurance facilities of the Export-Import Bank. The Bank already offers guarantees on medium-term credits and will now streamline its procedures in this field. In addition, it will guarantee, to the extent of 90 per cent, short-term credits (up to 180 days), which are used mainly to finance exports of consumer goods. Full details are not yet available but, according to preliminary reports, such guarantees are to cover so-called political risks, ranging from nonconvertibility or nontransferability of currencies to expropriation and acts of war; ordinary commercial risks, such as insolvency of the buyer, would not be covered.

Export credit insurance, in one form or another, is available in many foreign countries, as a rule under government sponsorship. For the United States, however, it is a major innovation. In the past, the Export-Import Bank has found relatively little demand for its medium-term credit insurance on the terms offered. With changed circumstances, availability of a broader program has been urged as an important part of any export development package.

The individual steps in this program are "modest," the President's message stated, but their cumulative effect will be "substantial if American enterprise will make the necessary effort."

In his article in *Foreign Affairs,* the Secretary of the Treasury stated there is no balance-of-payments "emergency," but saw the task of bringing our payments "into reasonable equilibrium" as "formidable." The first step to solution is to understand the problem. It is indeed helpful that public understanding is growing.

Signs of Improved Trade

U.S. merchandise exports last year, excluding those supplied under military aid programs, amounted to $16.3 billion, approximately equal to those in 1958. The decline from the exceptionally high levels of 1957 came to an end in mid-1959; during the second half of the year, exports, seasonally adjusted, were 9 per cent above the first half. The upward trend would have been even stronger had not many manufactures been held back by the prolonged steel strike.

U.S. Merchandise Trade

(In Billions of Dollars)

	Annual Average 1954-56	1957	1958	1959 Year	1959 1st Half*	1959 2nd Half*
Exports†	$14.8	$19.5	$16.3	$16.3	$15.6	$17.1
Imports	11.4	13.0	12.8	15.2	14.8	15.6
Export Surplus	$ 3.4	$ 6.5	$ 3.5	$ 1.1	$ 0.8	$ 1.5

*Annual rates, seasonally adjusted. † Excluding shipments of military goods financed through defense aid.

Source: U.S. Department of Commerce.

Merchandise imports, on the other hand, increased by almost one fifth from 1958 to a record level of $15.2 billion in 1959. Toward the year end, however, the rise slowed. During the second half, imports were only 6 per cent above the first six months.

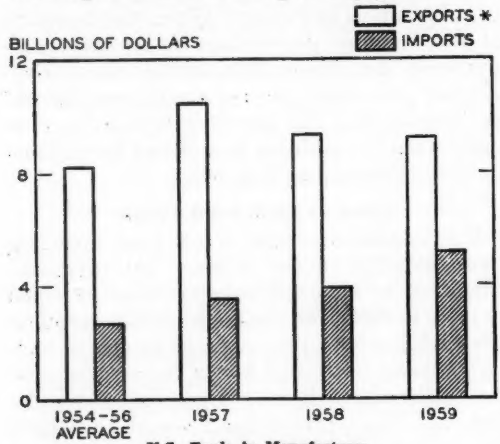
As a result, our merchandise export surplus during the second half of 1959 was at an annual rate of $1.5 billion, as against $0.8 billion during the first six months. For 1959 as a whole, the export surplus stood at $1.1 billion; this was the first time since 1953 that it fell below $1.5 billion.

In the first two months of this year exports ran 20 per cent higher than in the same period last year. Imports in January (latest available) were at about the same level as in January 1959.

The Performance in Manufactures

The focus of interest in the changed U.S. trade picture lies in manufactured goods. Our exports of manufactures have slipped during the past two years, but still make up over one half of total exports. Manufactured goods imports, up $1.3 billion in 1959, are now one third of total imports. Thus, net exports of manufactures – exports less imports – were lower in 1959 than in any other recent year. This is the outcome of many factors, here as well as abroad, including

the remarkable growth in capacity and the intensified export efforts of Europe and Japan.



U.S. Trade in Manufactures

*Excluding shipments of military goods financed through defense aid.

A particularly notable rise occurred last year in imports of iron and steelmill products. As a result, steel imports exceeded exports for the first time in over half a century. Although the steel strike was mainly responsible, the adverse trend had begun several years ago, as also was the case in the automobile industry. Last year, some 670,000 passenger cars were imported, or 50 per cent more than in 1958. Car imports were, in number, six times as large as exports.

The United States is maintaining its paramount position in exports of machinery. At $3.6 billion last year, they accounted for more than one third of our exports of manufactures. Chemical manufactures rose somewhat; and, in the latter part of the year, aircraft exports increased as deliveries abroad of jet aircraft commenced.

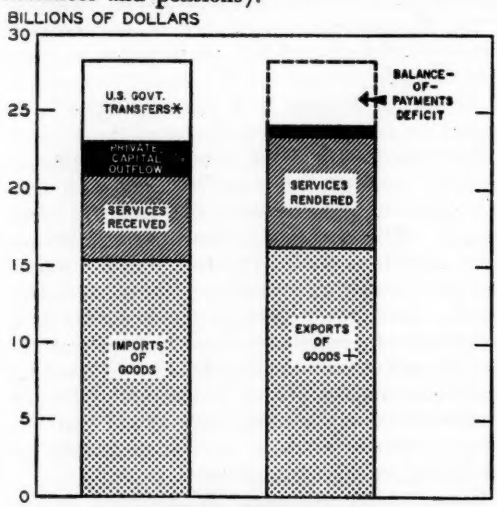
In reviewing last year's performance in manufactures, it should be remembered that business re-expansion in the United States (and Canada) preceded that in Western Europe by about nine months. This in part explains the rise in our imports and the sluggishness of our exports. Another reason was the relatively low level of export prices – and hence of export earnings – of the primary-producing countries. In the second half of 1959, there was a rise in our exports to overseas sterling-area countries whose exchange earnings were helped by better markets for wool and rubber; but gains were more moderate or delayed in Latin America, a market relatively more important to the United States than to Europe or Japan.

Continuing Adjustment Problems

By and large, recent trends in U.S. trade point toward an increase in our trade surplus in 1960. Booming business activity in the major industrial countries, and further export gains by the primary-producing countries, are enlarging purchases in the United States. It should be noted, at the same time, that the ebullience of European business is being restrained by discount rate increases and other steps to check excessive demand. The thought is, as here, that the present economic advance can be healthier and more durable if it is prevented from moving too fast.

Some of the current improvement in exports is attributable to special or temporary factors, as in the case of jet aircraft or cotton. In appraising our trade performance, allowance should also be made for the fact that some of our agricultural exports could not be moved without government subsidies and various facilities to finance them – including payment in buyers' currencies that have a limited usefulness to the United States.

The United States also has large receipts from "services" – shipping, insurance, etc., as well as income from investment abroad; these considerably exceed our payments on this score. Last year, the combined surplus on trade and service account was about $2.2 billion (excluding U.S. military cash outlays abroad, but including remittances and pensions).



U.S. Balance of Payments, 1959

*Military expenditures abroad, economic grants, and loans (net).
+Excluding shipments of military goods financed through defense aid.

The United States supplies dollars to foreign countries not only through purchases of goods and services but also through private investment and U.S. Government military cash expenditures, economic grants, and loans. In 1959, private capital investment and government loans were considerably lower than in the previous year.

With interest rates higher here than in foreign markets, new bond issues by foreigners in the

New York market were discouraged. Last year, in fact, such issues were only one half of the 1958 volume; the World Bank was out of the New York market altogether (it sold, however, a $125 million bond issue in February 1960). Largely as a result of the contraction in foreign capital issues, U.S. private capital outflow fell by $0.7 billion to $2.1 billion, the lowest since 1955; at last year's level, the outflow equaled the income derived by the United States from private investment abroad. The decline in total private capital outflow occurred despite a rise in direct investment abroad, especially in Europe.

Net U.S. Government loans were reduced by more than half — not because of any significant curtailment in loans but because of advance debt repayments by Germany, the United Kingdom, and a few other countries. Without these repayments, the payments deficit would have been nearly $500 million greater.

Another factor helping reduce the payments deficit was increased inflow of long-term foreign capital. Net foreign purchases of U.S. corporate securities were at a postwar high in 1959.

Nevertheless, when everything is added up, outpayments exceeded receipts by $3.7 billion,* the highest deficit on record; the year before, it stood at $3.4 billion.

The Gold and Dollar Outflow

Last year, the U.S. gold stock fell a bit more than $1 billion — against the heavy $2¼ billion loss in 1958. (From January 1 through March 30, 1960, it declined further by a nominal $48 million.) Diminished conversions of dollars into gold reflect confidence in the dollar as well as high money rates prevailing here until recently.

Since takings of gold were reduced in 1959, foreign short-term dollar assets accumulated more rapidly. Apart from working balances, such assets are carried in time deposit accounts with major commercial banks or invested in U.S. Government securities (mainly Treasury bills and certificates) and bankers acceptances. The table shows an increase of no less than $1,702 million in foreign holdings of U.S. Treasury bills and certificates during 1959, against a $136 million rise in 1958; on the other hand, deposits, which increased by $955 million during 1958, were drawn down by $445 million last year.

The fall in deposits at a time when total liquid assets held by foreigners are increasing rapidly is largely explained by the Federal Reserve Board's Regulation Q, which limits interest rates payable on time deposits to a maximum of 3 per cent, as discussed elsewhere in this *Letter.*

*Not counting the additional subscription to the International Monetary Fund ($1,375 million, of which $344 million in gold). For details, see the November 1959 issue of this *Letter*, page 129.

Dollar Assets Held at U.S. Banks for Foreign and International Account

(In Millions of Dollars)	Change during 1958	Change during 1959	Held Dec. 1959
Assets held by foreign countries			
Deposits, demand and time	+ 955	— 445	8,039
U.S. Treasury bills and certificates	+ 136	+1,702	6,524
Bankers accept., coml. paper, etc.	— 90	+ 278	1,526
Subtotal	+1,001	+1,535	16,089
U.S. Govt. bonds and notes	— 237	+ 504	1,487
Total	+ 764	+2,039	17,576
Assets held by international institutions*	+ 300	+1,779	3,818
GRAND TOTAL	+1,064	+3,818	21,394

*Includes the International Monetary Fund's holdings of non-negotiable, non-interest bearing demand notes of the United States ($2,065 million in December 1959) and also its holdings of U.S. Treasury bills purchased with proceeds from the sale of gold to the U.S. Treasury ($500 million in December 1959).
Sources: U.S. Treasury Bulletin and Federal Reserve Bulletin.

Need For Perspective

What is needed most in appraising our balance-of-payments problems and prospects is a sense of perspective. As far ahead as can be seen, the dollar's basic worth and stability are beyond question. It would be most damaging not only to American prestige but also to the financial strength of the entire Free World if Americans or foreigners should take fright at shadows. Yet, our payments deficit must not be taken lightly. For it could not be sustained for many years, nor will it be corrected by the mere passage of time without conscious effort.

This effort is rightly being directed toward strengthening our ability to supply goods and services at competitive prices and to preserve a feeling of complete confidence in the dollar by Americans as well as by bankers, finance ministers, and investors abroad. As the leading international trader, the United States would lose by slashing imports, for these enable foreign nations to buy American goods and service their debts.

By the same token, it is essential that obstacles to trade be reduced by our trading partners. Western Europe and other industrially-advanced nations have attained new high levels of prosperity. Direct quantitative restrictions on dollar goods have now been largely dismantled in countries with ample, if not overflowing, reserves. But it is also important to review tariffs, which in many countries are much higher than in the United States, and to remove the potential discrimination against outsiders, including the United States, implied in the new regional arrangements in Europe.*

To cope with today's trade and payments problem, therefore, it is essential to restore a sustainable balance throughout the *whole* world by means that enlarge trade and promote economic growth and efficiency. The prize of success is vigor and cohesion of all Free Nations.

*See "Europe's Six and Seven" in the January 1960 issue of this *Letter*.

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